BRIEF IN SUPPORT OF THE PETITION.

The Evidence Offered Was Legally Sufficient to Require a Finding as to the 1930 Cost to Petitioner of the Pressed Steel Shares.

The purpose of the present brief is to summarize the decisions by the Tax Court and by the Circuit Courts of Appeals, in conflict with the decision of the Court below, on the principal question sought to be reviewed by the present petition,—the adequacy of petitioner's proof, for the purpose of Federal Income and Undistributed Profits Tax, of the value in 1930 of petitioner's shares issued for the Pressed Steel common stock, and hence the amount of gain realized by petitioner through the sale thereof in 1936.

The question being as to the cost of the Pressed Steel shares to petitioner in 1930 (and not its transferor's cost), if such shares had been acquired by the petitioner for cash the amount of such cash would, of course, have been the cost. Similarly, if the shares had been acquired in exchange for a segregated amount of petitioner's stock, which had at the time a clearly ascertainable market value (measured by contemporaneous sales of similar stock in the open market) the cost of the Pressed Steel shares would be taken to be the aggregate fair market value of the stock the petitioner issued in exchange for them. In such a case, where petitioner's shares had a demonstrable market value, this would be conclusive, irrespective of any testimony as to the fair value of the Pressed Steel shares acquired. Such was the decision of the Court below in *Hazeltine Corporation v. Commissioner,* 89 F. (2d) 513.

However, when the asset in question is acquired by the issuance of petitioner's stock, and the fair market value of the latter cannot be ascertained from sales in the open mar-

ket, the Commissioner, the Tax Court and the Federal Courts have repeatedly and consistently held that the fair value of the stock issued in exchange for the asset (which represents the cost of the asset) may be measured by the fair value of the asset acquired, whatever the number of the shares of such stock.

On page 28 of their principal brief in the Court below, in the course of their argument on another point, the respondents said:

> "The courts have consistently held that in the absence of other evidence, the value of the stock shall be deemed to be the value of assets received in exchange therefor. Where all the capital stock of a newly formed corporation is issued for the property and there is no other method of measuring the fair market value of the stock so issued, however, such fair market value on that date may properly be determined to be the equivalent of the fair market value of the property received. *Commissioner v. W. S. Farish & Co.*, 104 F. 2d 833 (C. C. A. 5th); *Commissioner v. McKinney*, 87 F. 2d 811 (C. C. A. 10th). . . ."

The above rule is not, as the Tax Court and as the Court below in their decisions in the instant case apparently supposed, confined to cases where the entire stock of the newly organized corporation is issued for a single asset. Contrary to the ruling of the Tax Court and of the Court below in the case at bar, it has been applied equally by the Tax Court and by the Federal Courts to cases in which the particular asset under investigation has been acquired along with other assets in exchange for a block of stock having no recognized market value, and where there has been no segregation of the numbers of shares issued in exchange for each of the assets acquired. For that matter, if a taxpayer should undertake arbitrarily to apportion the shares issued among the several assets acquired, this would not be conclusive.

The principle is analogous to the Best Evidence Rule. The cost of the asset being the value of the block of stock issued in exchange for it, if such stock has a recognized market value, evinced by open sales, this is conclusive, irrespective of any testimony as to the fair value of the assets acquired in exchange for the stock. Where, however, the stock has no such recognized market value, unless such value may be taken as equivalent to the value of the property received, the taxpayer would, in such cases, be absolutely precluded from showing the cost basis *which the Court holds to be the proper basis for computing his tax.* In the case at bar, the Court below has expressly held that such basis is the cost to petitioner in 1930 and not the cost to petitioner's transferor in 1926. If the cost to petitioner's transferor in 1926 had been $10,000,000 instead of $1,000,000, would petitioner be permitted to use the $10,000,000 figure and claim a $4,000,000 loss on the sale of this asset for $6,000,000 in 1936, which was admittedly worth but $3,500,000 when acquired by petitioner in 1930, merely because no one could determine exactly how many of petitioner's shares were exchanged for it?

It is difficult to understand why either the Tax Court or the Court below considered that it would be instructive or helpful in solving this problem to ascertain what was the fair value of the assets acquired for the 360,000 shares *in addition* to the Pressed Steel stock, since the mere fact that one or more items in addition to that in question were received in exchange for a block of stock cannot affect the application of the principle. The Court below, in making its ruling, assumes that the fair market value of the Pressed Steel shares exchanged with other assets for the 360,000 shares of petitioner's common stock, was $3,500,000, but adds, in effect, that where any other substantial asset formed part of the consideration for the 360,000 shares, the value of the Pressed Steel shares could in no case be taken as the value of *whatever portion* of the stock was issued for them.

The proposition that the cost of one of several assets acquired for stock cannot be measured by the then fair market value of that asset leads inescapably to a completely unworkable result. In order to simplify the question, let us assume that the block of 360,000 shares was issued only for the Pressed Steel shares and those of Ambi-Budd; that the fair market value of the Pressed Steel shares was $3,500,000, and that of Ambi-Budd $1,000,000. The total stock acquired would admittedly be worth $4,500,000, and under the cases cited by the Tax Court, the value of petitioner's shares issued in exchange for the two items, and hence their cost, would be $4,500,000. It is, however, no greater assumption to assume that the value of *whatever part* of petitioner's stock was issued for each of the items should be measured by the fair value of *such item*.

Under the decisions it is a proper assumption that the fair value of *all* the shares issued is equal to that of *all* the assets received. It is no more unreasonable to assume that the value of whatever *part* of the shares was issued for a given asset is equal to the value of that asset, irrespective of what other assets were at the same time acquired by the issue of other shares, and irrespective of the number of shares issued in exchange for the asset in question. Indeed, where several assets were acquired for a large block of stock, it is immaterial for the purpose of the present question how many shares were issued in exchange for the respective assets, since it is not the unit value of the shares which we are considering, but the cost of the asset acquired, which is the *total value* of the shares issued in exchange for it, *whatever be the number of shares or whatever be the value of each share*. There can be no doubt that the Pressed Steel shares were acquired in exchange for some part of the 360,000 shares, but neither the actual number nor the unit value of that part is important —merely the aggregate value of *all* the shares issued for the Pressed Steel shares, *whatever their number and value be*.

Prior Decisions by the Tax Court Contrary to That in the Case at Bar.

The Court below and the Tax Court were entirely in error in supposing that the principle of using the fair value of the asset acquired as a measure of its cost has been confined to cases of the issue of the stock of a newly formed corporation in exchange for a *single asset*. The test of the application of the principle is not whether one asset or more was acquired at the same time, but whether the stock issued in exchange had a recognized market value without reference to the value of the asset acquired. The decisions of the Board of Tax Appeals prior to that in the present case are uniform to this effect. The first case announcing this principle is *Appeal of William Ziegler*, 1 B. T. A. 186, 192, where the Board thus stated it:

> ". . . The usual method of appraising stock issued for property *where there is no evidence of the market value* of the stock is to say that the stock is deemed equivalent in value to the property for which it was issued, and by determining the value of the property one can determine the value of the stock." (Italics supplied.)

This case was cited with approval and followed by the Board in *Appeals of Plunkett, et al.*, 3 B. T. A. 1265, and *Rouse, Hempstone & Co., Inc.*, 7 B. T. A. 1018. In the latter case the Board stated the principle as follows:

> "We are convinced from the evidence that the petitioner's merchandise inventory at December 1, 1917 had a market value of at least $286,349.72. As the inventory, among other assets, was purchased for stock, that amount then becomes the cost of the merchandise to the petitioner, for, where goods are purchased for stock, in the absence of evidence of the market value of the stock, it is deemed equivalent in

value of the property for which it was issued." (p. 1024)

In the case last cited the Board used the respective inventory values of the numerous items of merchandise as the basis for determining profit on the sale of such items, irrespective of the fact that the whole inventory was acquired by the issue of a block of stock, with no possible allocation of any specific number of shares to the respective items.

Under the Commissioner's regulations, where it is necessary to fix the cost of certain items of property acquired, for a lump sum, with other items, this is done proportionately to the value of the several items. Article 23 (l) 4 of the Regulations provides:

> "In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and non-depreciable property for a lump price, as, for example, buildings and land, the capital sum to be replaced is limited to an amount which bears the same proportion to the lump price as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time."

In accordance with the foregoing principle, where two items are acquired, one having a value of $1,000,000 and the other a value of $3,500,000, the method for determining the cost of the item worth $3,500,000 is to allocate the shares by reference to the items' respective values, that is, to determine that $\frac{3,500,000}{4,500,000}$ times the total shares were issued for that item. It would follow that $\frac{3,500,000}{4,500,000}$ times $4,500,000, or $3,500,000, was the cost of the item. Now suppose another case, where two items were so transferred,

and one was worth $3,500,000 but the other was worth $5,000,000. Applying the same principles, the total value of the stock would be $8,500,000 and of this $\frac{3,500,000}{8,500,000}$ would be allocated to the asset worth $3,500,000. The cost of that asset would then be $\frac{3,500,000}{8,500,000}$ times $8,500,000, or $3,500,000.

The value of the *other* asset, the cost of which is not being determined, has absolutely no effect on the result. We submit that the ends of justice cannot be served by a rule requiring a taxpayer, at his peril, to prove a fact which has *no bearing whatever* on the point in issue.

In *John Glackner Realty Corp. v. Commissioner,* 11 B. T. A. 151, the question was as to the amount of profit made by petitioner during the calendar year 1921 from the sale of two properties. The petitioner was organized in January, 1919, and immediately thereafter issued all its capital stock, consisting of 4500 shares, to John Glackner, the president, "in exchange for *four* properties situated in the Borough of Manhattan, New York City," no particular number of shares being allocated to any one property.

In 1921 petitioner sold *two* of the properties, the first for $13,536 and the second for $61,062.50. Expert witnesses, having knowledge of the properties and of their market value, testified as to what was the market value of the two properties respectively on January 17, 1919, when the corporation acquired them. "The respondent has offered no evidence to contradict the testimony of these witnesses, and we see no reason why their opinions are not to be relied on."

They testified that the value of the first property was $12,500 and that of the second $59,000. Although there was apparently no testimony as to the values of the other two properties, the Board held that the respective values

of the two properties sold, less proper depreciation, fixed the basis for the profit realized by their sale. Commissioner Murdock said (p. 152):

> "since the petitioner issued all of its capital stock for these two properties and two others, as a whole, the cost thereof to the petitioner was the market value of the properties at the date of acquisition. Rouse, Hempstone & Co., Inc., 7 B. T. A. 1018, 1024; and see Terrace Drive Co., 5 B. T. A. 1161."

The Board found no difficulty incident to the fact that the value of the other two properties was not shown, or to the circumstance that there was no segregation of the shares issued for the two properties in question. The question was precisely that here involved.

The *Ziegler* case was also quoted with approval by the Board in *Schoenheit's Appeal*, 14 B. T. A. 33 (reversed on other grounds in 44 F. (2d) 476), and the principle was followed by the Board in *Melrose Trust Co.*, 22 B. T. A. 538.

In *Reliance Investment Co. v. Commissioner*, 22 B. T. A. 1287, decided by Board Member Sternhagen, it appeared that in 1925-1926-1927, petitioner sold certain bonds of the Rock Island Railroad *which, with bonds of other companies*, it had acquired in 1914 in exchange for all its stock. The Bloch Brothers Tobacco Company having, on February 5, 1914, delivered to the petitioner bonds having a total face value of $1,212,051 in exchange for 19,985 shares of petitioner's stock, the remaining 15 shares being issued 3 to each of 5 individuals, on payment of $5 a share.

The Commissioner contended that the cost to petitioner was measured by the fair value of the bonds on the date of their acquisition, February 5, 1914, while the petitioner contended that the basis was the higher cost paid by its predecessor before March 1, 1913. The Board adopted the Commissioner's contention. Member Sternhagen said (pp. 1289-1290):

"The petitioner in 1925, 1926 and 1927, sold property which it had in 1914 acquired in exchange for all its stock. The respondent computed the gain from these sales upon the basis of the cost to petitioner in 1914. The cost was taken to be the value of petitioner's stock when issued for the property, and such value was taken as the equivalent of the stipulated value of the property received. *This is the long accepted way of determining such cost.* William Ziegler, Jr., 1 B. T. A. 186; Mead Realty Co., 21 B. T. A. 1062." (Italics supplied.)

This decision, flatly contrary to that by the same Member in the case at bar, is not referred to by him in his present opinion.

In *Gillette Rubber Company v. Commissioner,* 31 B. T. A. 483, 490, Board Member Goodrich said:

"The parties agree, and upon examination we accept their conclusion, that petitioner's acquisition of the assets of the old company and the distribution of its securities did not constitute a statutory reorganization. Consequently, the cost basis of the assets in the hands of the old company does not carry over and it becomes necessary to determine the basis of the assets in the hands of petitioner. It is clear that the fair market value of the securities issued in payment for the assets is the cost basis for the assets in petitioner's hands. Sec. 204 (a), (c), Revenue Act, 1926; sec. 111 (a), sec. 113, sec. 114, sec. 23, Revenue Act, 1928, as to basis for determining gain or loss and allowances for depreciation. Likewise, it appears that if the fair market value of the securities so issued cannot be determined from the record of sales thereof, or other evidence pertaining to the securities, then the value to be assigned to them, and to be taken as the cost basis of the assets in petitioner's hands, is the fair

market value of the assets for which they were exchanged. For statements and discussion of this rule see: *William Ziegler, Jr.*, 1 B. T. A. 186; *Wallis Tractor Co.*, 3 B. T. A. 981; *George A. Ricker*, 10 B. T. A. 11; *John Glackner Realty Corporation*, 11 B. T. A. 151; *Kanawha City Co.*, 13 B. T. A. 912; *Jefferson Livingston*, 18 B. T. A. 1184; *Reliance Investment Co.*, 22 B. T. A. 1287; *Biscayne Bay Islands Co.*, 23 B. T. A. 731; *Stollwerck Chocolate Co.*, 4 B. T. A. 467, 470."

In *Himmelhoch Brothers & Co.*, 26 B. T. A. 541, 547, the Board said:

"Where, as here, property is exchanged for stock, and there is no evidence as to the value of the stock, the value of the property when acquired establishes the cost of the asset to the transferee. *Rouse, Hempstone & Co.*, 7 B. T. A. 1018; *John Glackner Realty Corporation*, 11 B. T. A. 151; *Whiting Lumber Co.*, 21 B. T. A. 721; *Mead Realty Co.*, 21 B. T. A. 1062; *Melrose Trust Co.*, 22 B. T. A. 538."

See also *Lyon, Inc.*, 42 B. T. A. 1094, 1101 (footnote).

Conflicting Decision by the Tenth Circuit.

The case of *Commissioner v. McKinney*, 87 F. (2d) 811, decided by the 10th Circuit in January, 1936, is directly in conflict with the decision of the Court below in the case at bar.

There the question was as to the tax liability of the individual respondent for 1927. On November 13, 1922, respondent inherited nine oil and gas leases which, plus cash in the sum of $6,195.36, on May 23, 1924, she transferred to Johneda Oil Company in exchange *for all its capital stock.*

At the time she acquired the nine leases, their fair values were as follows:

Okesa	$ 712.21
Preston	3,414.60
Shepherd	930.59
Osage Foster	4,560.72
Collier	276.04
Buchanan	2,759.68
Elgin	11,714.28
Section 5, Osage Co.	4,426.49
Sections 22 and 23, Osage Co.	28,776.38
Total	$57,570.99

During the period between November 13, 1922, and May 23, 1924, oil was discovered on the lease on sections 22 and 23 in Osage County, and the fair market value of that lease on the date of the transfer was $247,500, that of the other leases being the same as on their acquisition. The estimated recoverable oil content of sections 22 and 23 was 300,344 barrels.

In 1927 respondent received a distribution from the corporation of $165,519.20. The question was as to what part of the distribution was from depletion reserve and what part was a dividend. The Commissioner computed the depletion from sections 22 and 23 on the basis of transferor's cost $28,776.38, or at about 9½¢ per barrel, holding that $140,449.35 of the $165,519.20 constituted dividends and but $25,069.85 a return of capital. If, however, the depletion were computed on the basis of the cost to the corporation measured by the value of the lease at the date of transfer ($247,500)the depletion per barrel would be at the rate of about 82½¢ per barrel and a much less part of the distribution constituted dividends. The Board of Tax Appeals (32 B. T. A. 450, 456), in an opinion by Member Turner, held that the amortization was to be based on the cost of the respective leases to the corporation *at the time of the transfer.*

There was, of course, no testimony obtainable as to the unit value at this time of the stock of the Company, other than the fact that all such stock had been issued in exchange for the nine leases plus the $6,195.36 cash. Accordingly, the use of the figure $247,500 as the cost of the lease on sections 22 and 23 necessarily involved the conclusion that, in such a case, the fair value of the stock issued for such lease (whatever its amount in shares) was the then fair value of such lease. The Board so held and said (p. 456):

> "It is well settled that the cost to a corporation of the property acquired through the issuance of its capital stock is the fair market value of such capital stock on the date issued, and where all of the capital stock of a corporation is issued for property and there is no other method of measuring the fair market value of the stock so issued, such fair market value on that date may properly be determined to be the equivalent of the fair market value of the property received. Reliance Investment Co., 22 B. T. A. 1287; Mead Realty Co., 21 B. T. A. 1062; L. H. Philo Corporation, 16 B. T. A. 130; John Glackner Realty Corporation, 11 B. T. A. 151; Realty Sales Co., 10 B. T. A. 1217.
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> "It has been stipulated that the fair market value of the lease on sections 22 and 23, Osage County, the property forming the basis for the controversy herein, was $247,500 on the date acquired by the Johneda Oil Co. for its stock, and, under the decisions cited, this value was the cost of the property to the corporation."

The Circuit Court of Appeals for the Tenth Circuit affirmed the judgment of the Board of Tax Appeals, holding, in an opinion by Judge Phillips, that for the purpose of determining what part of the distribution was dividends, the cost of the leases to the corporation was the fair market value at their date of acquisition by the corporation and not the cost to the transferor, this, despite the fact that in

reckoning the profit of respondent in the sale of the stock, the basis would be the cost to the transferor. Accordingly, the Court sustained the position of the taxpayer, making it necessary to determine the cost to the corporation of the respective leases at the date of their acquisition by it.

Having determined that the basis was the cost to the corporation, the Court held that this cost was measured by the value of the respective leases at the time of their acquisition by the corporation, using $247,500 as the cost of the lease in sections 22 and 23, although, as in the case at bar, this asset was acquired by the corporation *together with other assets* in exchange for all the corporation's stock. It was there possible to segregate $247,500 as the cost of the lease on sections 22 and 23, only by assuming that the fair value of the amount of stock issued in exchange *for such lease, whatever the number of shares or their unit value,* was equal to the fair value of the asset received for such stock. Apparently the Court found no such difficulties as the Court below did in its original opinion. The case involves precisely the question here presented. Judge Phillips said, in the course of the opinion (p. 816):

> "The cost of the leases to the corporation was the value of the stock less the cash paid in by respondent. The value of the stock is measured by the value of the leases received in exchange for the stock at the time of the transfer, or $276,304.61 plus the cash paid in by respondent."

In this case, as in the case at bar, it was impossible to determine what part of the stock on which respondent received his dividends had been issued for the $6,195.36 cash and what part for each of the nine leases, yet the court had no hesitation in arriving at the cost of *such part* of the stock as was issued for the lease on sections 22 and 23, as the then market value of that lease, *without determining how many shares had been issued for such lease.*

Other Federal decisions point to the same conclusion.

In *Hunt v. Commissioner,* 82 F. (2d) 668, certain items of the machinery which had been purchased with taxpayer's stock, were not delivered because of the insolvency of the owner and taxpayer claimed a deduction by reason thereof, but proved neither the fair value of the stock at the time the contract was made, nor the value of the machinery. The court held that he had not made out his case, but said (pp. 670, 671):

> "In the absence of proof as to what that machinery was worth, petitioner is without any basis to compute his loss for failure to deliver any part of it. He cannot do this by proving what the balance of the treasury stock sold for at a later period, or what the stock was worth when considerable sums of money had been paid in on the plant. The basis for the determination of his loss is the value of the stock when it was contracted to be given in exchange for the machinery. *If he had proven this by proving the value of the machinery at that time, he would have established his cost basis.* If he had proven that the half of the machinery which was not delivered continued to be of the same value, and that it was worth more than the $22,500 cash paid in lieu of delivery, to the extent of the difference he would have established his loss. . . . (Emphasis supplied.)
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> "In this state of the record, with no proof of what the stock was worth at the time the contract was made to measure the value of the machinery by, nor of the value of the machinery to measure the value of the stock by, there is no basis in the record for a deduction allowance on this score; indeed, the reasonable deduction from all the evidence is that there was no loss."

That the cost of shares is the value of assets transferred in exchange for them, see also *Volker v. U. S.,* 40 F. (2d) 697, W. D. Mo.

It is respectfully submitted that this case involves several important questions of Federal law on which the decisions of the lower Courts are in conflict and which should be settled by this Court.

Respectfully submitted,

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